Supreme Court, U.S.
FILED
JUL 3 1991
OFFICE CLERK

No. 90-1156

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF THE AMERICAN GAS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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July 3, 1991

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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BRIEF OF THE AMERICAN GAS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

The American Gas Association (hereinafter "A.G.A.") submits this brief *amicus curiae* in support of the petitioner, New Orleans Public Service Inc. (NOPSI).

INTEREST OF THE *AMICUS CURIAE*

The A.G.A. is a national trade association representing the interests of some 250 member companies involved in the distribution and transmission of natural gas throughout the 50 states and the District of Columbia. A.G.A. member companies account for approximately 85 percent of the nation's annual gas utility sales. The

vast majority of A.G.A.'s member companies distribute natural gas to residential, commercial and industrial customers and are extensively regulated by state public utility commissions.

The question presented in this case regarding the scope of the filed rate doctrine is of particular interest to the members of the A.G.A. that are local distribution companies ("LDCs" or "distributors"). LDCs purchase natural gas from pipelines and other sources at rates regulated by the Federal Energy Regulatory Commission (FERC) under the Natural Gas Act of 1938, 15 U.S.C. §§ 717-717w (1982) ("NGA"), and the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.* (1982) ("NGPA"), and distribute and resell that gas to retail customers at rates regulated by state utility commissions. The possibility of dual federal-state oversight could subject an LDC to inconsistent regulation, with FERC approving an LDC payment pursuant to published rates at the wholesale level and a state commission barring the LDC from recovering that same payment through its retail rates. The filed rate doctrine is designed to prevent the "trapping" of such payments by requiring state commissions to allow LDCs to recover through their retail rates all FERC-approved wholesale rates. The doctrine thus plays a crucial role in defining the proper relationship between federal and state regulation of the natural gas industry.

In *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) and in *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), this Court has refined and affirmed the filed rate doctrine. The decision of the United States Court of Appeals for the Fifth Circuit in *New Orleans Public Service, Inc. v. Council of the City of New Orleans*, 911 F.2d 993 (1990) is clearly inconsistent with the principles articulated by the Court in those decisions. Moreover, the Fifth Circuit's decision may engender confusion about the scope

of the doctrine by leading state utility commissions to conclude that they may prevent a local distribution company from recovering FERC-approved wholesale rates.

A.G.A. recognizes that there should be an opportunity to examine the prudence of a utility's decisions in many areas. However, the Fifth Circuit's decision opens the door to state regulatory agencies relitigating issues which were thoroughly reviewed and lost in the proper federal forum or not even raised at all. Thus, A.G.A. requests this Court to restate its position on the "bright line" drawn by Congress between state and federal authority in the setting of wholesale rates. A clear delineation of the extent of state authority regarding FERC determined wholesale rates is necessary and A.G.A. submits this *amicus curiae* brief urging the Court to reverse the decision of the Fifth Circuit.

SUMMARY OF ARGUMENT

This Court has spoken clearly on the issue of the preemptive impact of federal jurisdiction over wholesale rates charged by interstate pipelines. In *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) (*Mississippi Power & Light*) and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (*Nantahala*), this Court held that pursuant to the filed rate doctrine, state utility commissions in setting retail rates must allow as reasonable operating expenses, payments pursuant to FERC-approved wholesale rates. In the instant case, the Fifth Circuit held that the New Orleans City Council was not preempted from disallowing NOPSI's recovery of $135 million of FERC-approved costs associated with the Grand Gulf I nuclear facility on the grounds such costs were imprudently incurred. This decision must be reversed because it is inconsistent with *Mississippi Power & Light* and *Nantahala*.

The actions of the City Council constitute a collateral attack on FERC proceedings and if allowed to stand,

would have the effect of nullifying FERC wholesale rate orders. *Mississippi Power & Light* held that state regulatory agencies may not conduct independent prudence reviews in order to prevent the recovery of FERC-approved wholesale rates. Therefore, the City Council is bound by FERC's allocation of 17 percent of Grand Gulf I costs to NOPSI, a decision affirmed by the United States Court of Appeals for the District of Columbia Circuit.

Moreover, the Fifth Circuit erred when it misinterpreted language in *New Orleans Public Service, Inc. v. Council of City of New Orleans* (*NOPSI III*), 491 U.S. 350 (1989) and *Nantahala* to support its conclusion that the City Council's rate order was not preempted by federal law. First, the court mistakenly relied upon language in *NOPSI III* holding that the City Council's order was not unlawful for federal abstention purposes to determine the merits of NOPSI's federal preemption claim. Second, the court incorrectly found that the City Council's disallowance of a portion of FERC-approved costs was analogous to circumstances described in *Nantahala*, where retail rates might decrease if costs other than those resulting from the purchases of FERC regulated power or gas were to decrease.

The decision of the Fifth Circuit will lead to uncertainty about the filed rate doctrine and the parameters of the relationship between federal and state regulation of the natural gas and electric power industries. Such uncertainty could have a serious financial impact on local distributors. Accordingly, A.G.A. urges reversal of the Fifth Circuit's decision.

ARGUMENT

I. THE FIFTH CIRCUIT'S DECISION MUST BE REVERSED BECAUSE IT IS INCONSISTENT WITH THE COURT'S DECISIONS IN *MISSISSIPPI POWER & LIGHT* AND *NANTAHALA*.

In *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) (*Mississippi Power & Light*) and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (*Nantahala*), this Court restated fundamental principles concerning the preemptive impact of federal jurisdiction over wholesale rates on state regulation. These decisions were strong affirmations of the "filed rate doctrine," which holds that state and local regulatory authorities in setting retail rates, are without authority to bar recovery of costs incurred pursuant to FERC allocated costs and rates.[1] This result is constitutionally mandated because under the Commerce and Supremacy Clauses of the United States Constitution (U.S. CONST. art. I § 8, cl. 3 and art. VI, cl. 2), states are without authority, either directly or indirectly, to establish or modify rates for the wholesale sale or transportation of natural gas and electric energy in interstate commerce. *See Maryland v. Louisiana*, 451 U.S. 725 (1981).

In *Nantahala*, the Court reversed a decision of the state supreme court allocating costs to the utility differently from the amount allocated by FERC in a wholesale ratemaking proceeding. Holding that the state commission's

[1] The development of the "filed rate doctrine" resulted from the application of principles of preemption in cases involving attempted state agency interference with wholesale rate regulation. Under the doctrine, a state regulatory agency may not exercise authority over retail sales of natural gas or power to prevent a local distribution company from recovering at retail its costs of paying FERC-approved rates for that gas or power. *See Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981); *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951). In *Nantahala* the Court confirmed that the application of the filed rate doctrine included both FERC-approved rates and FERC-approved cost allocations. 476 U.S. 953 at 966-67 (1986).

allocation was preempted by federal law, the Court found that costs incurred by a utility would be "trapped" unlawfully if they could not be passed on to ratepayers. 476 U.S. at 970.

In *Mississippi Power & Light*, the Court addressed the efforts of a state to avoid passing through FERC-approved costs of the Grand Gulf I project—the very project which is the subject of the instant case. The Court reversed a state supreme court decision which held that the Mississippi Public Service Commission must first examine the prudence of management decisions that led to the construction and completion of Grand Gulf I before passing through FERC-approved wholesale rates. In reversing, the Court found that the only purpose of the state prudence review was to determine whether FERC's allocation of Grand Gulf power to the utility should be "trapped" or passed through to the state's retail customers. 487 U.S. at 372, n.12. Affirming the principles of the filed rate doctrine as discussed in *Nantahala*, the Court held:

> a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price. . . . *Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable.* A State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.

Mississippi Power & Light, 487 U.S. at 373, quoting *Nantahala*, 476 U.S. at 965, 966 (emphasis added).

The City Council's disallowance of $135 million of FERC-approved costs in this current case constitutes a collateral attack on FERC's determination of just and reasonable wholesale rates. Unless reversed, the Fifth Circuit's holding will permit states to further their own

parochial interests by relitigating issues lost at FERC and federal courts in front of a friendlier forum—their own state courts. All of the issues raised by the City Council concerning the recovery of FERC-approved wholesale rates, FERC's jurisdiction to determine the allocation of Grand Gulf I costs, the prudence of the Grand Gulf project, and the merits of such issues, already have been fully litigated and decided in the federal arena, and indeed by this Court. The City Council was an active participant in the FERC proceeding which allocated 17 percent of Grand Gulf I costs to NOPSI, a decision affirmed by the D.C. Circuit and reduced to final judgment.[2]

After losing its case at FERC, the City Council then subsequently conducted an independent prudence investigation and decreased the amount NOPSI could recover. There is no relevant difference between the actions of the City Council and the decision of the Mississippi Supreme Court reversed by the Court in *Mississippi Power & Light*. Accordingly, application of the well-defined principles above mandates the reversal of the Fifth Circuit's decision.

Both *Mississippi Power & Light* and *Nantahala* involved the interpretation of the Federal Power Act, 16 U.S.C. § 824 (1982), under which wholesale sales and transportation of electric power in interstate commerce are regulated by FERC. This is done pursuant to a statutory framework virtually identical to that governing regulation of wholesale sales and transportation of natural gas in interstate commerce under the Natural

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[2] *Middle South Energy, Inc.*, 26 FERC ¶ 63,044 (1984); 31 FERC ¶ 61,305; on reh'g, 32 FERC 61,425 (1985), aff'd *sub nom. Mississippi Industries v. FERC*, 808 F.2d 1525, reh'g granted and vacated in part, 822 F.2d 1103 (D.C. Cir.), cert. denied, 484 U.S. 985 (1987), on remand *sub nom. System Energy Resources, Inc.*, 41 FERC ¶ 61,238, aff'd, 42 FERC ¶ 61,091 (1988), aff'd *sub nom City of New Orleans v. FERC*, 875 F.2d 903 (D.C. Cir. 1989), cert. denied, 110 S. Ct. 1805 (1990).

Gas Act. *See Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n. 7 (1981). Thus, the principles of the filed rate doctrine apply equally to the wholesale and transportation of natural gas in interstate commerce. Natural Gas Act, 15 U.S.C. § 717(c) (1982). If state regulatory agencies were not required to accept FERC's determination of wholesale rates as just and reasonable, state agencies could undermine FERC's exclusive authority over such wholesale rates, nullify FERC-approved rates, and seriously impact the comprehensive federal scheme of regulation under the Natural Gas Act and Natural Gas Policy Act.

Affirmance of the filed rate doctrine as stated in *Mississippi Power & Light* and *Nantahala* also furthers principles of fairness, protecting distributors from the financial injury that would result if they were caught in the middle of regulatory disputes between FERC and the state regulatory agencies. Uncertainty about the recovery of the payment of filed rates will jeopardize the financial integrity of distributors. A distributor must be assured that it can act on the basis of FERC's decisions that a particular cost is reasonable, without fear that state regulators might conclude differently and prevent the utility from recovering such amounts from its ratepayers. A utility simply cannot stay financially sound or raise additional capital on reasonable terms if it cannot recover its costs.

II. THE CITY COUNCIL LACKS JURISDICTION TO CONDUCT AN INDEPENDENT PRUDENCE REVIEW OF NOPSI'S ACTIONS CONCERNING THE ALLOCATION OF GRAND GULF COSTS.

The issue of whether the City Council can conduct an independent prudence review of NOPSI's actions with respect to the Grand Gulf project has been foreclosed by the courts. The City Council's attempted distinction between the prudence of constructing Grand Gulf and NOPSI's alleged failure to minimize its losses during the

completion of construction is merely an effort to achieve indirectly what it cannot do directly.

This Court ruled in *Mississippi Power & Light* that FERC has jurisdiction to consider questions of prudence regarding the Grand Gulf project in the process of determining the wholesale rates charged by Middle South Energy to the four operating companies and in allocating Grand Gulf's costs and power. 487 U.S. at 375. As a party to the FERC proceeding, the City Council is bound by FERC's allocation of 17 percent of costs associated with Grand Gulf I to NOPSI. During the FERC proceeding, the City Council specifically argued that NOPSI should be allocated only 8.43 percent of Grand Gulf I costs (26 FERC ¶ 63,044 at 65,097 (1984)) and disputed the allocation methodology (26 FERC at 65,105); the administrative law judge discussed the various allocation methodologies proposed by the intervening regulatory authorities, rejected the City Council's proposal, and concluded that NOPSI should bear 17 percent (26 FERC at 65,109). This was expressly upheld by FERC initially (31 FERC ¶ 61,305 at 61,655), on rehearing (32 FERC ¶ 61,425 at 61,959-961) and eventually affirmed by the D.C. Circuit (See note 2, *supra*). If the City Council wanted to litigate issues of prudence which would affect the amount allocated to NOPSI, it should have done so during the FERC proceeding.

Moreover, according to this Court, "FERC's order specifically bars a state regulatory agency from evaluating the prudence of Grand Gulf 'in light of local conditions' alone." 487 U.S. at 376. FERC expressly rejected arguments that allocation of Grand Gulf costs should be based on whether individual companies "need" Grand Gulf's capacity on the grounds that the project was built primarily to serve the system as a whole and the Middle South companies approach power planning on a system-wide basis (32 FERC ¶ 61,425 at 61,958). FERC also rejected the City Council's arguments concerning the al-

location of Grand Gulf costs by finding that MSU is an integrated system (41 FERC ¶ 61,238 at 61,622). FERC further stated, "MPSC did not have any authority to approve an allocation methodology . . . for Grand Gulf . . . any proposed sale of Grand Gulf power and allocation of Grand Gulf costs was subject to review and approval by FERC under the Federal Power Act." 26 FERC ¶ 63,044 at 65,112. As held in *Mississippi Power & Light*, it follows that the City Council "cannot evaluate either the prudence of MSU's decision to invest in Grand Gulf . . . or the prudence of [a utility's] decision to be a party to agreements to construct and operate Grand Gulf without traversing matters squarely within FERC's jurisdiction." 487 U.S. at 376. Thus, the City Council's argument that it has the authority to examine the prudence of NOPSI's actions as they relate to the allocation of Grand Gulf power must fail.

III. THE COURT OF APPEALS ERRED BY ATTEMPTING TO DISTINGUISH THE CITY COUNCIL'S PRUDENCE REVIEW FROM THAT FORECLOSED IN *MISSISSIPPI POWER & LIGHT*.

The Fifth Circuit's finding that the City Council's prudence review could be distinguished from that rejected by this Court in *Mississippi Power & Light* is insupportable. First, the reasoning employed by the Fifth Circuit in order to determine that the City Council's prudence review was not preempted by federal law is erroneous. The Court of Appeals misinterpreted the Court's language in its recent decision in *New Orleans Public Service, Inc. v. Council of City of New Orleans*, 491 U.S. 350, 109 S. Ct. 2506, 105 L.Ed. 2d 298 (1989) (*NOPSI III*). That decision addressed the dismissals by the federal district court and Fifth Circuit of NOPSI's request for injunctive relief and declaratory judgment that the City Council's order was preempted by federal law.[3] In *NOPSI III*, this

[3] *New Orleans Public Service, Inc. v. Council of City of New Orleans*, 850 F.2d 1069 (5th Cir. 1988).

Court reversed and remanded for further proceedings, holding that abstention by the federal courts under *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943) and *Younger v. Harris*, 401 U.S. 37 (1971) was improper. In doing so, this Court stated that "[N]othing in [the City Council's order] is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it." 491 U.S. at 367, 109 S. Ct. at 2517, 105 L. Ed. 2d at 316. The Fifth Circuit mistakenly relies upon this language to hold that the Court in *NOPSI III* determined that the City Council was not preempted from regulating NOPSI's activities in this regard. 911 F.2d at 1002. However, the Fifth Circuit's reliance upon this language to determine the merits of the federal preemption issue is negated by its own characterization of *NOPSI III* as being limited to the issue of abstention. 911 F.2d at 998. Moreover, the Court of Appeals' finding would effectively result in the reversal of the filed rate and federal preemption doctrines, which had shortly before been upheld by this Court in *Mississippi Power & Light*.

The Fifth Circuit further erred by concluding that the City Council's disallowance of $135 million of Grand Gulf I costs fell within the parameters of circumstances discussed in *Nantahala*, when it stated: "[I]f states may deny passthroughs because costs have gone down in other areas, it seems logical that they should be able to deny them because costs would have gone down if the utility had not been imprudent." 911 F.2d at 1002. This conclusion is based upon a misreading of applicable precedent. In *Nantahala*, the Court noted that "an increase in FERC-approved wholesale rates need not lead to an increase in retail rates" and that ". . . such a divergence between wholesale and retail rates would occur only if costs *other than* those resulting from the purchases of FERC-regulated power or gas were to decrease." 476 U.S. at 968, citing *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972

(1978) (emphasis in the original). This statement merely recognizes that retail rates are calculated on the basis of a large basket of costs. Those costs include FERC-approved payments to interstate pipelines, which are not subject to state manipulation or review, and other costs which may be examined at the state level. Examples of such costs which are not regulated by FERC but are components of an LDC's retail rates include taxes, depreciation of physical plant and all other operating expenses. A utility that must pay higher FERC-approved rates might be able to offset its overall costs of doing business as a result of efficiencies leading to reduced operating costs, or changes in exogenous variables such as the weather or economic conditions affecting the cost of capital.[4] Clearly, the Court's observation in *Nantahala* does not apply to the instant case where the City Council expressly decreased the amount of FERC-approved costs to be recovered.

The decision of the Fifth Circuit will leave courts uncertain about the application of the filed rate doctrine and may lead state regulatory agencies to conclude that they have greater latitude in disallowing recovery of FERC-approved wholesale rates than this Court intends. The recent ruling in the parallel state proceeding between these parties is a result of that uncertainty. On April 4, 1991 the Fourth Circuit Court of Appeals for Louisiana issued its decision in *Alliance for Affordable Energy, Inc. et al. v. Council of the City of New Orleans*, Nos. 90-CA-0420, which addressed the appeals of the Alliance for Affordable Energy and NOPSI of the City Council's rate order. The state appellate court held that NOPSI could only recover approximately 9 percent of Grand Gulf costs, the same amount urged by the City Council and rejected by FERC. The state court's ruling demonstrates that the relationship between state law inquiries and the comprehensive scheme of federal regulation must be clearly defined and necessitates reversal of the Fifth Circuit's decision.

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[4] *Energy Law and Transactions*, § 2.07 (1990).

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Fifth Circuit which is inconsistent with *Mississippi Power & Light Co. v. Mississippi ex. rel. Moore*, 487 U.S. 354 (1988) and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) should be reversed.

Respectfully submitted,

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